

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
ALTERNATIVE INVESTMENT MANAGEMENT (AIM) PROGRAM**

May 15, 2006 August 18, 2008

This Policy is effective immediately upon adoption and supersedes all previous Alternative Investment, Alternative Emerging Investment, and Private Investment Policies.

I. PURPOSE

~~This document sets forth the investment policy ("the Policy") for the Alternative Investment Management (AIM) Program ("the Program"), as defined in the AIM Program Strategy ("the Strategy") and AIM Annual Plan. The design of this Policy ensures that investors, managers, external resources, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the market. Additional specific information regarding program management may be found in the AIM Program Process Manual available from AIM Staff.~~

The CalPERS Total Fund Statement of Investment Policy, adopted by the CalPERS Investment Committee ("Committee"), sets forth CalPERS' overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the investment policy ("Policy") for the Alternative Investment Management (AIM) Program ("Program"). The design of this Policy ensures that investors, managers, consultants, and other participants selected by the California Public Employees' Retirement System ("CalPERS" or "System") take prudent and careful action while managing the Program. Additionally, use of this policy assures sufficient flexibility in managing investment risks and returns associated with this Program.

II. STRATEGIC OBJECTIVE

Maximizing risk-adjusted rates of return while enhancing CalPERS'~~the System's~~ position as a premier alternative investment manager is the strategic objective of the Program.

The Program shall be managed to accomplish the following:

- A.** Enhance CalPERS'~~the System's~~ long-term total risk-adjusted return;

- B. Enhance CalPERS'~~the System's~~ reputation as a premier alternative investment manager and "investor of choice" within the private equity community;
- C. Hedge against long-term liabilities; and,
- D. Provide diversification to CalPERS'~~the System's~~ overall investment program; and
- E. ~~Consider solely the interests of the System's participants and their beneficiaries in accordance with California State Law and the Prudent Expert Standard as defined in Section II of the System's Investment Policy. <This statement is included in the Total Fund Statement of Investment Policy and is being deleted for that reason.>~~

III. RESPONSIBILITIES AND DELEGATION

- A. ~~The **System's Investment Committee** ("the Investment Committee") shall approve and amend the Policy, approve the Strategy and AIM Annual Plan, oversee performance, delegate decision making to the System's Investment Staff ("the Staff") as appropriate and authorize those investment and other decisions which have not been delegated to Staff.~~
- B. ~~CalPERS Investment Staff ("Staff") is responsible for~~ duties include, but are not limited to, the following:
 - 1. All aspects of portfolio management including monitoring, analyzing, and evaluating performance relative to the appropriate benchmark. Make recommendations to the Investment Committee concerning the Program Strategy, Annual Plan, and Policy changes.
 - 2. Reporting to the Committee annually and more often if needed about the performance of the Program. Staff will also report monthly to the Committee regarding investment proposals it has received, the stage they are at in the pipeline, and their ultimate disposition. Manage day-to-day operations; retain, supervise and delegate work to the external resource(s) as appropriate, which may include overseeing due diligence activity.
 - 3. Monitoring the implementation of, and compliance with, the Policy. Staff shall report material concerns, problems, material changes, and all violations of guidelines and Policies to the Committee at its next meeting, or sooner if deemed necessary. These reports shall include explanations of the violations and appropriate recommendations for corrective action. Screen, evaluate and

~~approve investment proposals that meet delegated authority guidelines.~~

4. Evaluating and selecting Alternative Investments. ~~Screen, evaluate and recommend investment proposals to the Investment Committee that are beyond the scope of Staff's delegated authority.~~
5. In managing this Program, Staff will work cooperatively with the External Resources it has retained as part of the spring-fed pool. Their primary purpose shall be to serve as an extension of Staff. Staff may also use outside experts, as appropriate, to provide specialized expertise in various disciplines, on a one time basis. Monitor and report on Program performance.
6. Each investment will be supported by a prudent person opinion rendered by one of the External Resources in the Spring Fed Pool. Market the Program.
7. ~~Manage on an ongoing basis the spring-fed pool of external resources and notify the Investment Committee of changes in its composition.~~
8. ~~Report any deviations from the Policy to the Investment Committee.~~

B. The General Pension Consultant ("Consultant") is responsible for:

Monitoring, evaluating, and reporting quarterly, to the Committee, on the performance of the Program relative to the benchmark and Policy.

C. The General Partner is responsible for:

All aspects of portfolio management as set forth in each General Partner's limited partnership agreement or contract with CalPERS.

~~C. External Resource(s)~~ ("external resource(s)") ~~shall be retained as part of a spring-fed pool. Their primary purpose shall be to serve as an extension of Staff. External resources may include management consultants, accountants, industry specialists, traditional pension fund consultants, investment bankers, or industry experts. The Staff shall direct and manage the activities of the external resources.~~

~~D. Outside Experts~~ ("outside experts") ~~may be utilized, as appropriate, to provide specialized expertise in various disciplines, on a one time basis in support of the external resource pool.~~

IV. ~~LONG-TERM AND SHORT-TERM PERFORMANCE OBJECTIVES AND BENCHMARKS~~

A. Long-Term Performance Objective

The long-term expected performance objective of the Program shall be the 10-year rolling average for the total return of the [CalPERS Wilshire 2500 Index](#) plus a 300 basis point risk premium. The performance objective is net of fees and expenses.

Use of the CalPERS Wilshire 2500 Index reflects the opportunity cost of investing in [alternative investments](#) versus publicly traded common stocks. The 10-year rolling average smoothes short-term volatility, is intended to cover at least one complete market cycle, and is consistent with the anticipated average [term](#) of the ~~partnership investments and the expected average holding period for direct investments.~~

B. Short-Term Performance Objective

In order to address differences between the long-term performance objective and young or immature partnership investments, ~~CalPERS the System~~ shall use a short-term performance objective more appropriate to immature partnership investments as a monitoring device. The Program partnership performance shall be compared to Venture Economics Information Services ("Venture Economics") young fund median returns by [vintage year](#). "Young fund and short-term" shall be defined as the first five years of each individual partnership and the partnership composite portfolio. Exceeding the Venture Economics young fund universe median return, or ranking in the top 50% of the sample ~~universe as weighted by AIM Partnership portfolio actual sub-asset holdings over the most recent five years~~ is the short-term performance objective.

The short-term performance objective addresses characteristics of young or immature partnership investments that differ from the long-term rolling ten-year CalPERS Wilshire 2500 Index plus 3% performance objective.

These different characteristics include young partnerships with a shorter time frame, reduced liquidity, and lack of marking-to-market due to a low number of realizations in the early years. Another characteristic unique to young or immature partnership investments includes the "J-curve effect," which results in low or negative returns due to payment of annual [management fees](#) during a period when investments are typically carried at cost and returns have not yet been realized. Partnership investments require time to achieve realizations. Venture capitalists require time to build companies and develop value, and turnaround/corporate

restructuring managers also require time to implement strategic, financial, and managerial improvements.

V. INVESTMENT APPROACHES AND PARAMETERS

A. General Approach

1. Staff shall manage the Program as a whole with specific criteria appropriate to partnerships investments direct investments (including "Independently Sourced Investments" and "Co Investments") and New Vehicles.

a. Investment opportunities will be classified as partnership investments when decision-making and management discretion is granted to outside managers.

b. Investment opportunities shall be classified as direct investments if CalPERS the System retains discretion and manages the investment internally or through its external resource(s).

c. New Vehicles shall include innovative structures that provide a means to access investment opportunities, exploit CalPERS the System's strengths, and achieve the maximum risk-adjusted rates of return. New Vehicles may include partnerships and/or direct investments or both.

2. "Top down" strategic assessments shall identify portfolio weightings and identify the most attractive segments of the market for investing. Based on these assessments, the Staff shall proactively seek out the most attractive investment opportunities, while maintaining appropriate diversification.

3. Depending on the form and character of the investment, the Program sets minimum standards for each investment.

~~Under the Program, the Staff shall review and manage investments utilizing a specialized management strategy that shall be disciplined and opportunistic.~~

~~Staff shall manage the Program as a whole with specific criteria appropriate to partnership and direct investments. Investment opportunities will be classified as partnership investments when decision-making and management discretion is granted to outside managers. Investment opportunities shall be classified as direct investments if the System retains discretion and manages the investment internally or through its external resource(s).~~

~~“Top down” strategic assessments shall identify portfolio weightings and identify the most attractive segments of the market for investing. Based on these assessments, the Staff shall proactively seek out the most attractive investment opportunities, while maintaining appropriate diversification.~~

~~B. Program Annual Plan~~

~~The Investment Committee and Staff shall review the program annually via the Annual Plan process. The Staff shall develop an Annual Plan each year and present it to the Investment Committee for approval. The Annual Plan shall be based upon broad economic structural analysis, market conditions, and a review of the existing portfolio. The Annual Plan shall detail tactical priorities, costs, resource requirements, marketing plans, strategy enhancements, and other objectives.~~

~~C. Program Strategy~~

~~The Program Strategy shall be revised periodically as appropriate and updated annually through the Annual Plan.~~

~~— The Strategy shall contain the following elements:~~

- ~~1. Program goals and objectives;~~
- ~~2. Structure and management of the program;~~
- ~~3. Strategic approach to the asset class;~~
- ~~4. Roles and responsibilities; and~~
- ~~5. Resource requirements.~~

~~D. Management of Partnership Investments~~

~~The Program shall be continually refined to obtain the most effective mix of investments. The Program shall invest in traditional partnership investments, and, as appropriate, funds employing other structures. Partnerships shall be continually assessed for effectiveness in the following areas:~~

- ~~1. Fit with the Annual Plan;~~
- ~~2. Pace and timing of investment commitments, funding and return of capital;~~

3. ~~Diversity of sectors (industry, geographical, investment style, and others as appropriate);~~
4. ~~Performance according to stated objectives specific to the investment; and~~
5. ~~Performance relative to the short-term monitoring benchmark and to the long-term performance objective, as appropriate.~~

~~E. Management of Direct Investments:~~

~~The Program shall utilize two types of direct investments: Co-Investments, and Independently Sourced Investments.~~

1. ~~**Co-Investments** are direct investments by the System together with an existing general partner. The System may invest in the same security or a different security than the general partner. The investment may be with a partnership in which the System has invested or it may be from another partnership sponsored by the same general partner.~~
2. ~~**Independently Sourced Investments** come to the System through contacts other than the general partners with which the System has invested. The System shall avoid competing directly with its general partners in this segment.~~

~~F. Management of Strategic Investment Vehicles~~

~~Strategic Investment Vehicles shall include innovative structures that provide a cost effective means to access investment opportunities, exploit the System's strengths, and achieve the maximum risk-adjusted rates of return. Strategic Investment Vehicles may include partnership and/or direct investments.~~

~~G. Transaction Processes~~

1. ~~The Program shall process transactions efficiently. To accomplish this, the Staff shall serve as the "point of contact" regarding all transactions flowing through the System. The Staff shall direct and coordinate the activities of the Program's external resource(s) on a day-to-day basis. The Staff will then be able to monitor and control the process and ensure that due diligence standards are maintained. Additionally, Staff will play a significant role in marketing the program.~~

2. ~~For Partnerships, the policy goal will be to maintain timely responses to proposals and to process them efficiently and effectively. Partnerships in which the System is already an investor shall be subject to an expedited due diligence process that combines the on-going monitoring assessment with an update of the original due diligence. New partnerships that warrant consideration shall face a full due diligence review. Section VIII.A. contains an outline of the process for evaluating Partnerships.~~
3. ~~Direct Investments shall also be addressed in a timely fashion. Section VIII.B. contains an outline of the process for evaluating Direct Investments.~~
4. ~~Strategic Investment Vehicles shall also be processed in a timely manner. Underlying investments shall be evaluated relative to partnership and/or direct investment due diligence criteria as appropriate.~~

H. ~~Quality Control Processes~~

~~The Program shall employ a quality control process, which includes both the Staff and external resource(s) to monitor Program efficiency, track investment performance, and control risk.~~

1. ~~Process Monitoring — Staff monitors transaction processing to insure timely decision making and an effective process.~~
2. ~~Monitoring Portfolio Performance — Actual returns are compared to the short and long term benchmark as appropriate, and to the expected return for the investment.~~
3. ~~Risk Control — Program standards are maintained through the following processes:~~
 - a. ~~Assessing the level of diversification in the portfolio on a continual basis, including the level of diversification across investment style, geographic distribution, industry concentrations, and across other ranges as appropriate.~~
 - b. ~~Tracking and monitoring due diligence activity and reviewing the external resource's due diligence, monitoring activities and their internal policies and procedures.~~
 - c. ~~Identifying problems early and taking corrective action quickly.~~

1B. Specific Risk Parameters

There are specific risks associated with investments that shall be monitored and mitigated by CalPERS. Each segment of the alternative investment market contains uncertainties that are unique to it. CalPERS shall manage the following major categories of uncertainties commensurate with the expected return as an investment proposal is considered:

1. Financial Risk: Alternative investments ~~often may~~ employ a greater use of leverage (borrowing), which may lead to a greater volatility in returns. ~~For example, in leveraged buyouts, partnership and direct investments use above average borrowings in their capital structure.~~
2. Operating and Business Risk: Certain alternative investments may entail above average operating and business risk. ~~For example, venture capital investments often entail risks associated with developing new products, establishing new markets, and having untested and incomplete management teams.~~
3. Liquidity Risk: Alternative investments lack liquidity and typically have time horizons of 5-to-10 years. Secondary markets for such investments are very limited; ~~and, often, there is no current income.~~ The ability to negotiate specific "exit" rights (e.g., registration rights, puts and calls), are generally applicable to direct ~~transactions~~ investments. To a large extent this risk is considered during the asset allocation process at the fund level.
4. Country Risk: ~~Political, economic, and currency risks associated with investing outside of the U.S.~~
- ~~54.~~ Structural Risk: ~~CalPERS~~The System negotiates and structures specific fundamental rights and protections, which include mechanisms for taking remedial action. These basic protections include where appropriate [advisory committee](#) participation and specific termination provisions in partnership transactions; and anti-dilutions, put and call options, voting rights for material events, and other covenants and governance provisions in the case of direct investments.
- ~~6.~~ 5. Valuation Risk: Partnerships and co investments shall be evaluated to determine if the general partner employs an appropriate valuation discipline. For direct investments, the Staff shall review valuations to determine if they are reasonable.

~~7. Investment Evaluation Standards: Depending on the form and character of the investment, the Program sets minimum standards for each investment.~~

The portfolio shall reduce risk through appropriate diversification by geography, industry, vintage year and investment strategy.

~~J.~~ Guidelines for Evaluating Proposals

~~Proposed partnership, direct investment, and strategic investment vehicle opportunities shall be evaluated relative to their fit with the Program's Strategy and Annual Plan.~~

~~Section VIII contains outlines of specific guidelines for partnerships and direct investments, respectively. Strategic investment vehicles shall be evaluated according to the underlying structure of the investment, which may include partnership and/or direct investments.~~

~~KC.~~ Types of Investment Selections

1. The Program shall consider any appropriate investment opportunity with the potential for returns superior to traditional investment opportunities. Investments can be in any industry and geography and may include, but are not limited to:

a. Buyouts and Corporate Restructuring

b. Expansion Capital

c. Venture Capital

d. Distressed Securities

e. Turnarounds

f. Special Situations

2. Staff shall develop and maintain selection guidelines for Alternative Investments to include the following:

a. Minimum requirements with respect to the following:

(1) General Partner's relevant investment experience and specific qualifications:

(2) General Partner's ability to work together;

(3) General Partner's ability to dedicate sufficient time and attention to the undertaking;

(4) Basic investment vehicle terms;

(5) Investment goals and objectives; and

b. Performance criteria

c. Due Diligence process

d. Legal constraints or requirements

e. Reporting requirements

f. Quality control processes including, but not limited to, investment monitoring and risk control

g. Other relevant parameters that may apply

D. Investment Parameters

Alternative Investments may operate under a limited partnership agreement, limited liability company (LLC), or other similar legal structure.

All legal structures shall include specific, written investment guidelines. The guidelines shall outline the fund's investment philosophy and approaches, representative portfolio characteristics, permissible and restricted procedures, and a performance objective commensurate with the investment risk to be incurred.

~~The System shall consider any appropriate investment opportunity with the potential for returns superior to traditional investment opportunities, and not otherwise prohibited by the System. Investments shall generally fall within the categories defined below.~~

~~1. Buyout and Corporate Restructuring Capital: Investments in leveraged buyouts, management buyouts, equity buyouts, employee buyouts, buy-and-build, other acquisition strategies and restructurings, and related uses of capital.~~

~~2. Expansion Capital: Investments in established companies for the purpose of growing their businesses.~~

- ~~3. Venture Capital: Investments in relatively small, rapidly growing, private companies in various stages of development.~~
- ~~4. Energy and Natural Resources: Investments in the exploration, extraction, accumulation, generation, movement or sale of energy (e.g., oil, gas, coal, electricity), and other natural resources and related service companies.~~
- ~~5. Distressed Securities: Debt or equity securities investments in troubled companies, under the assumption that the securities will appreciate in value following a restructuring of the company's obligations. This includes, but is not limited to, investments in companies that are insolvent or unable to pay their debts as they come due. This may include companies subject to the Bankruptcy Reform Act, specifically Chapter 7 (Liquidation) and Chapter 11 (Reorganization), and companies under going restructurings outside of Bankruptcy Court.~~
- ~~6. Turnarounds: Investments in companies experiencing financial or operating difficulties. These companies may or may not be insolvent.~~
- ~~7. International: Investments that are located in foreign countries or have significant portions of their operations outside of the United States. International investments shall also be considered with respect to their specific type (e.g., corporate restructuring, venture capital, and so forth).~~
- ~~8. Special Situations: This includes all other types of investments, e.g., mezzanine strategies, active minority positions, hedge funds, secondary investments, governance strategies, industry specific strategies, and unconventional investments such as debt arrangements, collateralizations, corporate joint ventures, credit enhancements, leasing, off balance sheet financings, secondary market opportunities, and other types.~~

~~VI. BENCHMARKS~~

~~The Long-term Benchmark shall be the 10-year rolling average for the total return of the CalPERS Wilshire 2500 Index plus a 300 basis point risk premium. The Long-term Benchmark is net of fees and expenses.~~

~~The Short-term Monitoring Benchmark for AIM partnerships shall be to exceed the Venture Economics Young Fund Universe (past four years) median return, or to rank in the top 50% of the sample universe as weighted by AIM partnership~~

~~portfolio sub-asset holdings over the most recent four years. This analysis shall include performance comparisons by vintage year within each sub-asset class. The System shall use the monitoring benchmark as an early warning device to point out performance for further investigation and possible intervention.~~

VII. GENERAL

A. REPORTING

1. Reports received from Investment Partners

~~Staff shall require periodic reports from investment partners to facilitate monitoring and which are appropriate for the specific transaction.~~

2. Monitoring Investments

~~Staff shall monitor individual partnerships, direct investments and the portfolio as a whole. Monitoring includes diversification across alternative investment types and programs to assure an appropriate mix.~~

3. Performance

a. Partnership Investments

~~The System shall assess the performance of partnerships relative to the following areas:~~

- ~~(1) Objectives established by the partnership or the principals managing the investment (actual financial performance as compared to original plan)~~
- ~~(2) Risk undertaken~~
- ~~(3) Performance of other similar investments~~
- ~~(4) The short-term monitoring benchmark for partnerships in the first four years of their term~~
- ~~(5) The long-term performance objective, with appropriate interpretation if applied to the short-term.~~

b. Direct Investments

~~The System shall assess the performance of direct investments relative to the following areas:~~

- ~~(1) Actual financial performance of a company compared to the business plan and strategy~~
- ~~(2) Risk undertaken~~
- ~~(3) The performance of the company against its pro forma operating results, its industry and the total Program portfolio~~

~~c. Strategic Investment Vehicles~~

~~The System shall assess the performance of Strategic Investment Vehicles according to original plan and partnership and direct investment criteria as appropriate.~~

~~4. Investment Committee Reports~~

~~Quarterly and annual reports shall be provided to the Investment Committee. These reports include, but shall not be limited to, reviews of investments and their performance.~~

VIII. SPECIFIC CONSIDERATIONS

A. PARTNERSHIP INVESTMENT GUIDELINES

1. Minimum Requirements/Investment Styles

- ~~a. The principals shall demonstrate relevant experience in or directly applicable to the market in which they propose to work.~~
- ~~b. The principals shall demonstrate that they are specifically qualified to pursue the proposed strategy in the market in which they propose to work.~~
- ~~c. The principals shall demonstrate the requisite skills and experience necessary to execute successfully the proposed strategy, including evidence from similar endeavors of their ability to work successfully together.~~
- ~~d. The principals shall dedicate sufficient time and effort to the proposed opportunity and make, within the context of the~~

~~particular investment, a meaningful personal financial commitment.~~

- ~~e. The proposed strategy and business plan shall be set forth in sufficient detail to permit substantive and meaningful review of the opportunity, verification of the investment concept, and of the risk factors.~~
- ~~f. The proposed strategy and business plan shall provide reasonable assurance that the investment opportunity can produce the required return.~~
- ~~g. The risk/reward trade-off in the particular market that is addressed by a partnership proposal shall be attractive, based on reasonable assumptions.~~

~~2. Evaluation Criteria~~

~~Primary emphasis will be on the quality and experience of the general partners in a partnership investment. Additional factors may include, as appropriate:~~

- ~~a. Fit with the Program Strategy, Annual Plan, and within the overall AIM Portfolio.~~
- ~~b. A unique strategy that is not competitive with existing investments.~~
- ~~c. Integrity of the general partner, its employees, and other investors.~~
- ~~d. Quality of overall partnership governance, management of the partnership, including controls and reporting systems.~~
- ~~e. Specific objectives.~~
- ~~f. Relationship with the relevant parts of the investment community~~
- ~~g. Relationship with limited partners~~
- ~~h. Nature of value added involvement~~
- ~~i. Potentials for co-investments~~
- ~~j. Creativity of the general partners~~

- ~~k. Past financial performance~~
- ~~l. Reasonable ratio of investees to general partners~~
- ~~m. Reasonable ratio of committed capital to general partners~~
- ~~n. Appropriateness of terms and conditions and alignment of interests with limited partners~~

~~3. Due Diligence~~

~~A due diligence review by Staff and external resource(s) selected for reviewing a transaction shall include the following, when applicable:~~

- ~~a. Discussions with principals of the proposed investment.~~
- ~~b. Review and analysis of all pertinent offering documents including: offering memorandums, subscription agreements, private placement memorandums and operative investment agreements.~~
- ~~c. Consideration of potential conflicts of interest, if any, posed by the proposed investment and prior investments and activities of the principals.~~
- ~~d. Review and analysis of the investment concept, including entry and exit strategies and terms including fees, principal participation, and structure.~~
- ~~e. Review and analysis of the fit within the AIM Program, including fit with the Strategy, Annual Plan, other constraints and guidelines, and compliance with applicable investment policies.~~
- ~~f. Review of news articles, principals, prior investments, and concepts.~~
- ~~g. Background and reference check of principals.~~
- ~~h. Review and analysis of track record including performance of prior and current investments.~~
- ~~i. Consideration of relative size of the proposed investment.~~

- j. ~~Investigation of special terms and side letter agreements with past or present investors.~~
- k. ~~Any analysis of the competition between a given proposal and an existing preferential relationship or alternative asset, which may include, but is not limited to, a review of the following: the size of the industry, the segment of the industry, and the deal flow for both the preferential relationship and the proposed investment.~~
- l. ~~Review of any lawsuits, litigation involving the general partner, its principals, employees and prior funds.~~

4. ~~Legal Constraints~~

- a. ~~Unrelated Business Taxable Income (UBTI): Partnerships are structured to minimize UBTI.~~
- b. ~~Registered Investment Advisor (RIA): Investment advisors retained by the Board are so registered or comparable procedure is established.~~
- c. ~~Regulatory (i.e. FCC, SEC, FTC).~~

5. ~~Other Parameters~~

- a. ~~Types of Allowable Investments: Any appropriate investment opportunity which has the potential for returns superior to traditional investment opportunities and which is not otherwise prohibited by The System.~~
- b. ~~Terms and conditions: Fees, preferred returns, profit splits, and other terms and conditions are negotiated as appropriate and when prudent. Partnerships will be prohibited from investing in real estate without approval by The System.~~
- c. ~~Use of Fund's name: Staff and external resource(s) identify any submitted investment opportunity containing as part of its name or title any reference to the System and immediately inform the proposer that inclusion of such a reference or use is inappropriate and unacceptable to the System and require that it be removed.~~

- d. ~~Hostile Transactions: The System maintains the right to examine transactions which might be construed as hostile transactions, with the right to decline participation.~~

B. ~~DIRECT INVESTMENT GUIDELINES~~

1. ~~Minimum Requirements~~

- a. ~~Management shall have compiled relevant business and management experience.~~
- b. ~~The entity in which the investment made shall be appropriately capitalized in the relevant circumstances.~~

2. ~~Evaluation Criteria~~

~~Primary emphasis shall be on the following:~~

- a. ~~Integrity of the general partner, its employees, and other investors.~~
- b. ~~The historical and prospective financial condition of the company.~~
- c. ~~The market position of the company, including its relative competitive position within the industry.~~
- d. ~~The growth prospects of the company and its industry in light of existing and anticipated economic conditions.~~
- e. ~~The underlying stability of the company's business.~~
- f. ~~The quality and sustainability of earnings, if appropriate.~~
- g. ~~The quality of the company's assets, such as manufacturing facilities, inventories, receivables, and other assets, including intangibles, essential to the company's operations.~~
- h. ~~Appropriate capital structure.~~
- i. ~~The quality, stability and experience of the management team, the Board of Directors, and other investors, including the quality of their interaction.~~
- j. ~~The quality of financial and operating controls and quality of reporting to management and investors.~~

~~k. The quality of the corporate governance.~~

~~l. The return potential of the investment, given its terms and conditions, compared to the perceived risks and the relative return/risk profile of comparable investments.~~

~~At a minimum, additional factors shall include the following:~~

~~a. The specific objectives and goals of the company and its management team.~~

~~b. The strategy to be employed to achieve the aforementioned objectives and goals. Management and investors should have a well thought-out plan for creating and realizing value from the company.~~

~~c. Controlling shareowner(s) and other institutional investors.~~

~~d. The relationship with the management team, the Board of Directors, other investors and any controlling shareowners.~~

~~e. Potential for future follow-on investment opportunities.~~

~~3. Due Diligence~~

~~For co-investments, Staff and external resource(s), if utilized, will rely heavily on the work of the general partner sponsoring the transactions, while conducting its own due diligence. Independently Sourced Investments will require a much more in-depth due diligence review because these investments do not come to the System through one of the existing general partners in the portfolio.~~

~~A due diligence review by Staff and the external resource if selected for reviewing a transaction shall include the following, when applicable:~~

~~a. Review of whether the proposed investment falls within the Strategy, Plan, constraints and guidelines, and if it complies with applicable investment policies.~~

~~b. A review and analysis of all pertinent offering documents, including offering memorandums, research reports, annual and quarterly reports, 10K, 8K, 10Q SEC reports and proxy statements.~~

- ~~c. A review and analysis of relevant research reports and news articles regarding the company, its management and its industry.~~
- ~~d. Background checks of the senior management team and any controlling shareowners.~~
- ~~e. A review of the company's historical financial operating results and present financial condition, including examination of auditor reports and possible interview of the auditor.~~
- ~~f. A review and analysis of the company's projected financial operating results with consideration given to the reasonableness of such projections and forecasts.~~
- ~~g. A review and analysis of any contingent liabilities, including potential liabilities related to anticipated legal action, environmental issues, under-funded pensions, taxes and insurance issues.~~
- ~~h. A review and analysis of the company's market position and its standing in its industry.~~
- ~~i. Third party reference checks with key suppliers, customers and, when advisable, competitors.~~
- ~~j. A review of the company's instruments of indebtedness, corporate instruments, board minutes and any special agreements between the company and other major investors.~~
- ~~k. A review of the company's relationship with its employees, including labor contracts.~~
- ~~l. A review and analysis of all relevant regulations and regulatory reports, examinations and ratings regarding the company and its business sector.~~
- ~~m. On-site visits to the company's principal facilities and corporate headquarters.~~
- ~~n. Interviews with board members, senior management and controlling shareowners.~~
- ~~o. A review of the ownership structure, employee benefit plans and anti-takeover provisions.~~

p. ~~An analysis of the competition between a given proposal and an existing preferential relationship or alternative asset, which may include, but is not limited to, a review of the following: the size of the industry, the segment of the industry, and the deal flow for the preferential relationship and the proposed investment.~~

q. ~~In addition to the foregoing and depending on the circumstances surrounding a potential investment, Staff may utilize outside experts to provide further analysis and commentary as to the merits of a particular investment.~~

~~4. Legal Constraints~~

a. ~~Unrelated Business Taxable Income (UBTI): Investments are structured to minimize UBTI.~~

b. ~~Registered Investment Advisor (RIA): Investment advisors retained by the Board are so registered or a comparable procedure is established.~~

c. ~~Regulatory (i.e. FCC, SEC, FTC)~~

~~5. Other Parameters~~

a. ~~Method of Participation: The System generally participates as a preferred or common stockholder or as a senior or subordinated debt investor with a common stock participation.~~

b. ~~Types of Allowable Investments: Any appropriate investment opportunity which has the potential for returns superior to traditional investment opportunities and which is not otherwise prohibited by The System.~~

c. ~~Terms and conditions: Fees, preferred returns, profit splits and other terms and conditions are negotiated as appropriate and when possible.~~

d. ~~Use of Fund's name: Staff and external resource(s) identify any submitted investment opportunity containing as part of its name or title any reference to The System and immediately inform the proposer that inclusion of such a reference or use is inappropriate and unacceptable to the System and require that it be removed.~~

- e. ~~Hostile Transactions: The System maintains the right to examine transactions which might be construed as hostile transactions, with the right to decline participation.~~
- f. ~~Corporate Governance~~
 - (1) ~~Voting: The System shall maintain full voting rights with respect to any class of securities in which it might invest. When appropriate, the System may wish to participate as part of a voting trust agreement under which a third party (e.g., a lead investor) retains its proxy to vote the System's interests.~~
 - (2) ~~Board of Directors Representation: As circumstances dictate, the System may wish to retain the right to have an independent representative or representatives of the System appointed to a portfolio company's Board of Directors. Furthermore, the Fund should allow the possibility to retain the right to have such representatives participate in select committees of such Board of Directors (e.g., Audit Committee, Executive Committee or Compensation Committee).~~
- g. ~~Board of Directors Visitations Rights: As circumstances dictate, the System should obtain the right to attend, as an observer, a portfolio company's Board of Directors meeting.~~
- h. ~~Board of Directors Composition: As circumstances dictate, the System should obtain agreements as to the composition of a Board of Directors, including guidelines on the number of outside Directors and the composition of key committees.~~
- i. ~~Special Voting Rights: As circumstances dictate, the System should obtain special class voting rights with respect to specific corporate governance matters such as proposals deemed contrary to the System's interests, for example, as in the case of hostile takeovers.~~

VI. CALCULATIONS AND COMPUTATIONS

Investors, managers, consultants, and other participants selected by CalPERS shall make all calculations and computations on a market value basis as which shall be recorded by CalPERS' Custodian.

IXVII. GLOSSARY OF TERMS

~~Definitions for k~~Key words used in the policy are defined located in the ~~Alternative Investment Management Program Glossary of Terms which is included in CalPERS' the System's Master Glossary of Terms.~~

Approved by the Policy Subcommittee:	April 4, 1997
Adopted by the Investment Committee:	April 14, 1997
Revised by the Policy Subcommittee:	March 11, 2005
Approved by the Investment Committee:	April 18, 2005
Revised by the Policy Subcommittee:	September 16, 2005
Approved by the Investment Committee:	October 17, 2005
Revised by the Policy Subcommittee:	April 14, 2006
Approved by the Investment Committee:	May 15, 2006
<u>Revised by the Policy Subcommittee:</u>	<u>August 18, 2008</u>

Asset Class Glossary: Alternative Investments Management
Policy: Alternative Investment Management Program
August 18, 2008

Advisory Committee

A group of investors in the partnership whose primary functions are to address certain partnership-related issues. Based on the roles and responsibilities outlined in limited partnership agreement, the Advisory Board may review conflicts of interest, approve valuation policies, review operating budgets, vote on partnership term extensions, and perform other duties as deemed appropriate.

Alternative Investments

Investments that are privately-held and illiquid. These investments are often structured as limited partnerships with strategies of investing in ~~may include~~ venture capital, growth equity, buyouts, mezzanine financing, and other investments strategies ~~that are~~ not based on public market activities.

Annual Plan

~~A strategic plan that provides details on tactical priorities for new investments together with a review of the existing portfolio. The first Annual Plan was approved by the Investment Committee on December 16, 1996.~~

Buyout

The purchase of all or part of the stock or assets of a company through the use of debt and equity. The company may be privately or publicly owned.

CalPERS Custom Wilshire 2500 Index

The Wilshire 2500 Index, excluding Real Estate Investment Trusts (REITs) and tobacco stocks, and with dividends reinvested. The Wilshire 2500 comprises the top 2500 securities of the Dow Jones Wilshire 5000 Index, excluding REITs and tobacco stocks, based on market capitalization, and is reconstituted annually. The Dow Jones Wilshire 5000 is an index that measures the performance of all U.S.-headquartered equity securities with readily available price data.

Co Investment

A direct investment into a portfolio company by limited partners alongside the general partner and generally done so on similar terms.

Commitment

~~A general partner's or limited partner's legal obligation to provide a certain amount of capital to a partnership.~~

Corporate Restructuring (Buyouts)

Investments in the form of equity and/or debt of a public or private company designed to restructure the current capital structure of the company, including debt and equity

buybacks, exchange offers and refinancings. Related terms include leveraged buyouts, management buyouts, employee buyouts, and buy-and-build strategies.

Direct Investment

An investment in which CalPERS has ownership interest in a company. ~~property or group of properties.~~

Distressed Securities

Debt or equity securities of companies that are in financial distress. These securities tend to trade at significant discounts and attract investors that perceive a turnaround.

Due Diligence

~~The process of investigating, evaluating, and analyzing a potential investment's characteristics, investment philosophy, and terms and conditions.~~

Due Diligence

The process of checking and verifying information as well as ensuring that sufficient analysis has been conducted before making an investment recommendation.

~~Employee Buyout~~

~~The purchase of a majority interest in a company by that company's employees.~~

~~Equity Buyout~~

~~An acquisition of a company for the purpose of restructuring its balance sheet by replacing existing debt with equity.~~

Expansion Capital (Growth Equity)

Investment in an established company for the purpose of growing its business.

External Resource(s)

Includes management consultants, accountants, industry specialists, traditional pension fund consultants, investment bankers, or industry experts.

General Partner

The manager of a limited partnership. The general partner has full responsibility and complete discretion for investing the capital. The general partner also bears personal liability for any lawsuits that arise from the investment's activities, but is often broadly indemnified by the fund limited partners.

~~Hostile Transactions~~

~~Transactions opposed by the board of directors of the target company.~~

Independently Sourced Investment

A type of direct investment which is sourced through contacts other than the general partners with which CalPERS is invested.

Leveraged Buyout

The purchase of all or part of the stock or assets of a company through the use of debt with some equity capital. The company may be privately or publicly owned, or a subsidiary or division of a privately or publicly owned company.

Limited Partner

An investor in a limited partnership. Limited partners provide the capital, but have no direct involvement in the day-to-day management of the fund. Limited partners have limited liability, but also have limited control over the management of the fund.

Limited Partnership

The most common format used in structuring private equity investments. Limited partners provide the capital but have no direct involvement in the management of the fund. Limited partners have limited liability but also have limited control over the management of the fund.

Management Buyout

Purchase of all of a company's publicly held shares by the existing management, which takes the company private. The financing structure may involve a significant amount of borrowed capital (thus resembling a leveraged buyout), or may have a more balanced debt and equity mix if equity financing is available to management.

Management Fee

The fee paid to the General Partner to manage the fund. cover the expenses of managing a fund. Fees cover expenses such as salaries, travel and office expenses, and costs of developing and monitoring investments. Management fees are typically paid out of a fund's committed capital and are generally returned before the profit is split with the general partner.

Preferred Return

A term in the partnership agreement that describes a minimum return that is paid to the limited partners before the general partner receives any share of the profits.

New Vehicle

An investment in a fund where CalPERS partners with a firm that has a distinctive competitive advantage in an industry, geographic region or investment style. New Vehicles shall be limited to investments in fund of funds or separate account investments.

New/Emerging Management Team

A new general partnership that raises a first or secondtime institutional fund. This may include funds being raised by an established General Partner that is targeting a new strategy or has hired a new management team.

Partnership Investment

An investment in a Limited Partnership

Prudent Person Opinion

An opinion from an External Resource that the proposed investments is a prudent investment consistent with Article XVI Section 17(c) of the California Constitution and Section 20151(c) of the California Government Code.

Return

A measure of the total performance of an investment over a designated time period. The return calculation for private equity is typically based on the internal rate of return, net of all fees and expenses.

Risk

A measurable probability of losing or not gaining value. Risk is differentiated from uncertainty, which is not measurable. Risk in this context is also referred to as "standard deviation", which is a statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution.

Special Situations

A term used to describe non-traditional investment strategies that are typical in private equity. Such non-traditional investment strategies include, but are not limited to, mezzanine strategies, active minority positions, governance strategies, sector-specific strategies, and other strategies that may use unconventional instruments such as debt arrangements, collateralizations, corporate joint ventures, credit enhancements, leasing, off-balance sheet financings, etc.

Term

The duration of the partnership or direct investment.

Transaction

An agreement between a buyer and a seller to exchange an asset for payment. A transaction often takes the form of a partnership, co-investment, or direct investment.

Turnarounds

Investments in companies experiencing financial and/or operating issues. These companies may or may not be insolvent.

~~Unrelated Business Taxable Income (UBTI)~~

~~Income regularly generated by a tax-exempt entity by means of taxable activities. This income is not related to the main function of the entity, but is needed to generate a small portion of income.~~

Venture Capital

The financing of rapidly-growing companies that do not have access to public equity or debt financing. Early-stage venture capital may involve financing a company during its initial years when assets may be limited and when there may be no revenues. Late-stage venture, sometimes referred to as growth equity or expansion capital, may involve financing a company that has established products or services and revenues.

Vintage Year

The year in which the first capital drawdown of the partnership occurs.